

capital gains q and a

perplexity

I bought a house in the City of Pasadena 5 years ago. I paid 1 million dollars for the house. 2 years ago I paid off the mortgage on the house which was \$300,000. I borrowed this money from my niece. I am now selling the house for 1 million \$300,000. I do not want to pay any capital gains that I am not legally liable for. Please provide information in a way that a five-year-old can understand that will enable me to successfully pay only the capital gains that I am legally liable for. Before answering this initial question please Ask me any questions that you need the answers for in order to fully answer the initial question.

Sources

<https://www.latimes.com/california/story/2022-05-14/lopez-column-equity-tax-proposals-high-end-real-estate-sales> favicon

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Answer

To successfully pay only the capital gains that you are legally liable for when selling your house in Pasadena, California, you need to consider the following information:

Exclusion for Capital Gains: If you used your home as a primary residence for at least 2 out of the last 5 years, you are exempt from \$250,000 of capital gains. For married couples, the exclusion is up to \$500,000 if certain conditions are met

Tax Rates: The state of California doesn't have a specific capital gains tax rate. Instead, the standard state tax rates are used, which range from 1% to 10.3% depending on the income bracket.

Calculation of Capital Gains: To calculate your capital gain or loss, you will need proof of the purchase price of the property, the current purchase price, the commissions paid when you first bought the home, and the total cost of all home improvements made.

Local Legislation: Some Californian cities have their own transfer tax systems, so it's important to check the local legislation before proceeding with the sale.

By understanding these points, you can ensure that you only pay the capital gains that you are legally liable for when selling your house in Pasadena, California.

you

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Before we can determine the capital gains you are legally liable for, I need to ask you a few questions:

Did you live in the house as your primary residence for at least 2 out of the 5 years you owned it? no

Have you made any improvements to the house during the time you owned it? yes

Are you planning to use the money from the sale of the house to buy another house? no

Please provide the answers to these questions so I can assist you further.

Based on the information provided, it seems that you may be liable for capital gains tax on the sale of your house. However, I will explain the concept in a way that a five-year-old can understand.

What are capital gains?

Capital gains are the profits you make when you sell something, like a house, for more money than you originally paid for it. It's like when you sell a toy for more money than you bought it.

Capital gains tax

Capital gains tax is a tax you have to pay on the profits you make from selling something, like a house. It's like when you have to share a portion of the money you made from selling a toy with someone else.

Primary residence exemption

Usually, when you sell your house, you may have to pay capital gains tax on the profit you made. However, there is a special rule called the primary residence exemption that can help you reduce or eliminate the amount of tax you have to pay.

To qualify for the primary residence exemption, you usually need to have lived in the house as your main home for at least 2 out of the 5 years before you sold it. But since you mentioned that you didn't live in the house as your primary residence, this exemption may not apply to you .

Improvements and deductions

However, there is still some good news. If you made any improvements to the house during the time you owned it, you may be able to reduce the amount of capital gains tax you have to pay. Improvements are like when you add something extra to your toy to make it better, like adding new wheels or decorations.

When you sell your house, you can subtract the cost of the improvements from the selling price. This means you only have to pay capital gains tax on the profit you made after deducting the cost of the improvements. It's like when you sell a toy car after adding new wheels, and you only have to share the extra money you made from selling the toy car with someone else.

Consult a tax professional

Since tax rules can be complex, it's always a good idea to consult with a tax professional or an accountant who can help you understand your specific situation and guide you on how to minimize the capital gains tax you have to pay. They are like experts who can help you figure out the best way to handle your taxes.

Remember, it's important to follow the tax laws and pay the taxes you owe. By seeking professional advice, you can ensure that you are paying only the capital gains tax that you are legally liable for.

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I bought a house in the City of Pasadena 5 years ago. From the time that I bought it the house says it either been rented or vacant. I have not lived in that house. I have improved the house by constructing a retaining wall that was needed that cost me \$40,000 to construct. I am not planning to use the sale of the house to purchase another house. I paid 1 million dollars for the house. 2 years ago I paid off the mortgage on the house which was \$300,000. I borrowed this money from my niece. I am now selling the house for 1 million \$300,000. I do not want to pay any capital gains that I am not legally liable for. Please provide information in a way that a five-year-old can understand that will enable me to successfully pay only the capital gains that I am legally liable for. Before answering this initial question please Ask me any questions that you need the answers for in order to fully answer the initial question.

Based on the information you provided, you are selling a house that you bought for \$1,000,000 and improved by constructing a retaining wall that cost you \$40,000. You paid off the mortgage of \$300,000 two years ago, and you are now selling the house for \$1,300,000. You are concerned about paying only the capital gains that you are legally liable for.

Capital gains tax is a tax on the profit you make when you sell an asset, such as a house. The amount of capital gains tax you owe depends on how much profit you made and how long you owned the asset. If you owned the house for more than one year before selling it, you will be subject to long-term capital gains tax rates, which are generally lower than short-term capital gains tax rates.

To calculate your capital gains tax, you will need to determine your “basis” in the house. Your basis is the amount you paid for the house, plus any improvements you made, minus any depreciation you claimed on the house. In your case, your basis would be \$1,040,000 (\$1,000,000 purchase price + \$40,000 improvement cost).

To calculate your capital gains, you will need to subtract your basis from the sale price of the house. In your case, your capital gains would be \$260,000

(\$1,300,000 sale price - \$1,040,000 basis).

If you owned the house for more than one year before selling it, you will be subject to long-term capital gains tax rates. For 2023, the long-term capital gains tax rates are 0%, 15%, or 20%, depending on your income tax bracket

To determine your exact capital gains tax liability, you will need to consult with a tax professional or use tax software. However, based on the information you provided, it appears that you would owe long-term capital gains tax on the \$260,000 profit you made from the sale of the house.

poe

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Questions:

How long have you owned the house?

Have you lived in the house since you bought it?

What improvements have you made to the house?

How much did the improvements cost?

Do you plan to use the sale of the house to purchase another house?

How much did you pay for the house?

How much is the mortgage on the house?

How much do you owe your niece?

How much are you selling the house for?

Answers:

I have owned the house for 5 years.

I have not lived in the house since I bought it.

I constructed a retaining wall that cost me \$40,000.

The improvements cost me \$40,000.

I do not plan to use the sale of the house to purchase another house.

I paid \$1 million for the house.

The mortgage on the house is \$300,000.

I owe my niece \$300,000.

I am selling the house for \$1.3 million.

Explanation:

The capital gains tax is a tax on the profit you make when you sell an asset. In this case, the asset is your house. The profit, or gain, is the difference between the amount you sell the house for and the amount you paid for it.

In your case, you paid \$1 million for the house and you are selling it for \$1.3 million. This means that you have made a gain of \$300,000. However, you are not liable for capital gains tax on the entire \$300,000 gain.

There are two reasons for this. First, you are allowed to exclude up to \$250,000 of gain from the sale of your home if you are single and up to \$500,000 of gain if you are married filing jointly. In your case, since you are single, you can exclude \$250,000 of your gain from the sale of your home.

Second, you can also deduct the cost of any improvements you made to the house from your gain. In your case, you spent \$40,000 on a retaining wall. This means that you can deduct \$40,000 from your gain.

After applying these two deductions, your taxable gain is $\$300,000 - \$250,000 - \$40,000 = \$10,000$. This means that you will only have to pay capital gains tax on \$10,000 of your gain.

The capital gains tax rate is 15% for most people. This means that you will owe \$1,500 in capital gains tax on the sale of your home.

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ChatGPT

Got it! To help you figure out how much capital gains tax you owe, I need a few details. Did you make any other improvements to the house besides the retaining wall? Also, have you been keeping track of all the expenses related to the property, like property taxes, insurance, and any other costs?

User

Did you make any other improvements to the house besides the retaining wall? I improve the Landscaping which cost me \$4,000. Outside of that only regular repairs and maintenance for a 70 year old house. Also, have you been keeping track of all the expenses related to the property, like property taxes, insurance, and any other costs? All of these expenses I have receipts for including property tax insurance and other cost.

ChatGPT

Great, thanks for the details! To figure out the capital gains tax you owe, you'll need to calculate the adjusted basis of your house. The adjusted basis is the original purchase price plus the cost of improvements and certain expenses you've incurred.

For your situation, start with the original purchase price of \$1,000,000. Then add the cost of improvements, which includes the \$40,000 for the retaining wall and the \$4,000 for landscaping. This gives you a total of \$1,044,000 as your adjusted basis.

When you sell the house for \$1,300,000, you'll subtract your adjusted basis from the selling price to determine your capital gains. In this case, $\$1,300,000 - \$1,044,000 = \$256,000$ in capital gains.

Now, if this property has been your primary residence for at least two of the past five years, you may qualify for a capital gains exclusion. This exclusion allows individuals to exclude up to \$250,000 (\$500,000 for married couples filing jointly) of capital gains from the sale of their primary residence.

However, since you haven't lived in the house, this exclusion may not apply to you. In that case, the \$256,000 in capital gains would be subject to capital gains tax. The capital gains tax rate can vary depending on your income tax bracket and the duration you've held the property.

To ensure you accurately calculate and pay only the capital gains tax you owe, consider consulting with a tax professional or accountant. They can provide tailored advice based on your specific situation and help minimize your tax liability within the bounds of the law.

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Thank you for providing the details. To help you understand and manage your capital gains taxes in a simple way, let's break it down step by step:

1. ****Initial Investment:****

- You bought the house for \$1 million.

2. ****Improvements Made:****

- You spent \$40,000 on a retaining wall.
- You spent \$4,000 on landscaping.

3. ****Mortgage Payoff:****

- You initially borrowed \$300,000 from your niece to pay off the mortgage.

4. ****Current Selling Price:****

- You are selling the house for \$1,300,000.

Now, let's calculate the capital gains:

$$\text{Capital Gains} = \text{Selling Price} - (\text{Initial Investment} + \text{Improvements} + \text{Other Costs})$$

$$\text{Capital Gains} = \$1,300,000 - (\$1,000,000 + \$40,000 + \$4,000 + \text{Other Costs})$$

The "Other Costs" would include any additional costs related to the sale, such as real estate agent fees, legal fees, etc. Make sure to include those.

If the result is a positive number, that is your capital gain. However, there are some exemptions and deductions you can consider:

1. ****Primary Residence Exclusion:****

- If you lived in the house for at least two out of the last five years, you might qualify for the primary residence exclusion. Since you mentioned you haven't lived in the house, this might not apply to you.

2. ****Improvement Costs:****

- The costs of improvements, like the retaining wall and landscaping, can be added to your home's cost basis, reducing the capital gains.

3. ****Other Selling Costs:****

- Deduct any other costs associated with selling the house.

Once you've calculated the capital gains and considered any deductions/exclusions, you'll have a better idea of the amount on which you might be subject to capital gains tax.

Please consult with a tax professional for accurate advice tailored to your specific situation, as tax laws can be complex and can vary. They can provide guidance on potential deductions and the most advantageous way to handle the sale for your unique circumstances.

poe

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I'm not a tax professional, but I can try to provide some general information that may help you understand the concept of capital gains and how they are calculated. However, it's important to consult with a tax advisor or accountant who can provide personalized advice based on your specific situation.

1. What is capital gains tax?

Capital gains tax is a type of tax you may need to pay when you sell an asset, such as a house, for a profit. It is calculated based on the difference between the purchase price (also known as the cost basis) of the house and the selling price.

2. How is the cost basis determined?

The cost basis of your house is generally the amount you paid for it when you bought it, which in your case is \$1 million. However, certain expenses like the cost of improvements, such as the retaining wall and landscaping, can be added to the cost basis. Regular repairs and maintenance are typically not included.

3. What are improvements?

Improvements are changes made to the property that increase its value or extend its useful life. In your case, the construction of the retaining wall and the landscaping improvements may be considered as improvements because they enhance the property.

4. How do improvements affect capital gains tax?

When you sell the house, the cost basis, including the improvements, will be subtracted from the selling price to determine the capital gain. In your case, if the selling price is \$1,300,000 and your cost basis is \$1,044,000 (\$1,000,000 + \$40,000 + \$4,000), then your capital gain would be \$256,000 (\$1,300,000 - \$1,044,000).

5. Are there any deductions or exemptions?

There are certain deductions and exemptions that may help reduce your capital gains tax liability. For example, if you've lived in the house as your primary residence for at least two of the past five years before selling, you may qualify for the Primary Residence Exclusion. This exclusion can reduce or eliminate your capital gains tax liability up to a certain limit. However, since you mentioned that you haven't lived in the house, this exemption may not apply to your situation.

6. How much tax will I have to pay on the capital gain?

The tax rate on capital gains depends on various factors, including your income level and the duration for which you held the asset. It's important to consult

with a tax professional who can help you determine the applicable tax rate and any deductions or exemptions you may qualify for.

Remember, this is just general information, and the actual tax implications can be complex. It's always advisable to consult with a tax advisor or accountant who can provide personalized advice based on your specific situation and help you navigate the tax requirements.

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Based on the details you've provided, it sounds like you may be eligible for a tax exclusion on the capital gains from the sale of your house. Here's a simple breakdown that a five-year-old can understand:

Imagine your house is like a big chocolate bar. When you bought the chocolate bar for \$1 million, you put some extra toppings on it (like the retaining wall and landscaping) that made it even better. Now, when you sell the chocolate bar for \$1.3 million, you want to make sure you only pay taxes on the extra \$300,000 you made, not the whole \$1.3 million.

To do this, you need to know about something called "capital gains." It's like when you trade your toy for a better one – you made a little extra, right? But

the good news is, if you've lived in the chocolate bar for at least 2 of the past 5 years, you might not have to pay taxes on the extra money you made.

So, the most important thing is to check if you've lived in the chocolate bar for at least 2 of the past 5 years. If you have, you might be able to keep more of your extra money from selling the chocolate bar without paying extra taxes.

Remember, it's always good to talk to a grown-up who knows about money stuff, like a tax professional, to help you with this. They can help make sure you only pay what you're supposed to and keep more of your chocolate bar money for yourself!